First in Service, Value and Return

March 5, 2010

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: NCUA Rules and Regulations Part 704 for Corporate Credit Unions

Dear Ms. Rupp:

FirstCorp agrees that regulatory reform is necessary as we navigate our way through the worst economic conditions this country has seen in eighty years. The National Credit Union Administration is to be commended for its commitment to reform and for allowing all credit unions the opportunity to provide input into this credit union reform.

When determining the future of corporate credit unions and good corporate regulation, NCUA needs to put the power in the hands of corporate member owners and allow credit unions to determine the future of the corporate network. It should continue to provide corporates the ability to add value to credit unions while still managing to accumulate capital via retained earnings. In other words, it should let corporates remain a viable alternative for credit unions as an option for payments systems, liquidity, and investments.

After a thorough review of the proposed changes to NCUA Rules and Regulations Part 704 for Corporate Credit Unions, it is our opinion that if this regulation becomes approved as written, credit unions will not have the opportunity to determine the future of corporate credit unions. It is also our opinion that certain provisions are overly restrictive and prohibit corporates from adding value to credit unions while simultaneously accumulating capital via retained earnings. Essentially, these provisions deny corporates any chance for viability. The following pages contain FirstCorp's recommendations regarding the proposed changes to NCUA Rules and Regulations Part 704 for Corporate Credit Unions.

704.3 Corporate Credit Union Capital
Adding a risk-based capital standard to the corporate rule provides for a credit risk measurement. This standard is a much needed addition to the proposed rule since underestimation of credit risk was a major contributor to the global economic meltdown. We support the proposed requirement of risk-weighting investments held on a corporate's balance sheet. Requiring higher levels of capital for riskier balance sheets is good regulatory reform.

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Under the capital provisions in the proposed rule, there are phase-in periods that start at the first anniversary of the corporate rule effective date and go through the tenth. Providing time for corporates to meet minimum thresholds shows an understanding of the fact that corporates will need time to comply with the new corporate rule. Corporates will be responsible for comprehending the impact of "legacy asset" disposal, generating business plans showing viability, building capital, and articulating plans for credit unions and regulators.

One of the requirements in the proposed rule mandates that 12 months after the date of publication of the final rule a corporate must maintain at all times:

1. *A leverage ratio of 4% or greater;*
2. *A Tier 1 risk-based capital ratio of 4% or greater; and*
3. *A total risk-based capital ratio of 8% or greater*

A total risk-based capital ratio equal to or greater than 8% with retained earnings and perpetual contributed capital in the numerator is the only requirement that should be placed on corporates at the 12 month deadline for the following reasons:

1. An 8% risk-based capital ratio with retained earnings and perpetual contributed capital in the numerator provides for a safe and sound corporate credit union with minimal risk to the National Credit Union Share Insurance Fund (NCUSIF).

2. All corporates are different and assume various levels of risk on their balance sheets. Corporates at or near the 4% leverage ratio twelve months after the corporate rule is final should not be forced to obtain additional capital from external sources when they carry an 8% risk-based capital ratio. Corporates that maintained a conservative investment portfolio and made it through the worst economic conditions in eighty years should not be forced to penalize their membership by asking for additional capital or facing potential liquidation or consolidation.

3. Thirty six months after the date of publication of the final rule in the Federal Register, the proposal calls for a corporate credit union to carry a 4% leverage ratio, an 8% total risk-based capital ratio, and 45 basis points of retained earnings. This is good regulatory reform and a reasonable mandate for corporate credit unions.

Recommendation

There should be only one provision regarding capital that is effective 12 months after the publication of the rule. It should read: *12 months after the date of publication of the final rule in the Federal Register a corporate must maintain at all times a total risk-based capital ratio equal to or greater than 8%.*

We agree with the following portion of the provision and believe it is good reform: *36 months after the date of publication of the final rule in the Federal Register a corporate must maintain at all times:*

1. *A leverage ratio equal to or greater than 4%;*
2. *A Tier 1 risk-based capital ratio equal to or greater than 4%; and*
3. *A total risk-based capital ratio equal to or greater than 8%.*

<u>704.5 Investments</u>

<u>(j) Grandfathering</u> - The grandfathering section of the proposed rule states that a corporate credit union's authority to hold an investment is governed by the regulation that was in place at the time of purchase. However, the proposed rule also states that all grandfathered investments are subject to the requirements of 704.8 (A/L Management) and 704.9 (Liquidity).

Assuming that grandfathered investments must meet the new proposed sections 704.8 and 704.9, most corporate credit unions will need to submit an investment action plan addressing investment securities that contribute to the corporate not meeting the "Cash Flow Mismatch Sensitivity Analysis". Creating detailed plans to justify bonds being held that are permissible under the current regulation is a waste of corporate credit union resources.

Many of the grandfathered investments that will have to be addressed in a written action plan, as defined in section 704.8 (j) Regulatory Violations, could be government agency floating rate securities and are not the cause of the current problems in the corporate network. Forcing the liquidation of such investments could cause a corporate to lock in losses that could otherwise be avoided if holding the bonds to maturity or until secondary bond markets become more efficient and functional.

Recommendation

Grandfathering provisions should be placed in sections 704.8 and 704.9 of the proposed rule providing for corporates to hold securities purchased legally under the current corporate rule.

<u>704.8 A/L Management</u>

<u>(c) Penalty for Early Withdrawals</u>

Dictating the redemption payout of a certificate to Par, or less than Par, does not make the corporate funding base more stable. This provision in fact makes the funding base for corporates less stable. The provision takes the "liquidity component" out of a CD purchased from a corporate. This will deter credit unions from considering a corporate CD purchase because they can't redeem CDs at anything better than Par. This restricts the ability of a corporate to attract funds and keep a balance sheet funded. This provision is overly restrictive and drives away potential investments in corporate credit unions.

Recommendation

Corporates must be provided the opportunity to add value to credit unions while simultaneously building capital via retained earnings. This provision needs to be stricken from the revised corporate rule providing for a corporate CD to be redeemed at market value levels.

(d) Interest Rate Sensitivity Analysis
The NEV modeling that has been performed for years by corporates has been successful in limiting the amount of effective duration, mismatch, and optionality mismatch that was present in the corporate system. This requirement is good regulation.

(e) Cash Flow Mismatch Sensitivity Analysis
The Cash Flow Mismatch Sensitivity Analysis requirement increases spreads on investment securities to determine price volatility and change in NEV. This analysis is flawed in that it assumes that our current market conditions, the worst economic conditions experienced in this country in eighty years, will always exist. Although good regulatory reform is needed as financial markets have changed, this analysis is overly restrictive and limits the ability of corporates to take on manageable risk necessary to be a viable entity. The provision assumes an extreme operating environment and:

1. Assumes financial markets will not function properly.
2. Targets the attributes of a bond and not the real causes of why spreads widen.
   a. Credit deterioration of the underlying assets of a bond is the primary reason that spreads widen.
   b. Spreads should be shocked on bonds that could experience spread widening due to "poor credit underwriting". If the credit quality of assets supporting a bond remains strong, the bond will experience minimal spread volatility. If the credit quality of assets supporting a bond deteriorates, the bond will experience more spread volatility.
3. Assumes all investment securities, regardless of type, carry a 100% probability for spreads to widen by 300 basis points.

Applying the Cash Flow Mismatch Sensitivity Analysis to FirstCorp's current balance sheet creates a NEV erosion of approximately 75%. The limit in the proposed rule dictates NEV erosion of no more than 15%. Our analysis assumes daily average net assets of $1 billion, a leverage ratio of 4%, and that we fully understand the modeling requirements of this section of the proposed rule. FirstCorp is a conservatively run "Base Case" corporate as defined by the current rule, sits at five times over the proposed NEV erosion limit under the proposed Cash Flow Mismatch Sensitivity Analysis.

A corporate must have the ability to add value to credit unions while simultaneously building capital – in other words, be a viable entity. Excluding government agency securities from being included in the analysis and including bonds from investment sectors that have proven to require such analysis, as those with the highest risk weightings as listed in the proposed corporate rule, improves the provision. Corporates choosing to operate with a more conservative risk posture and choosing to hold investments carrying lower levels of risk such as government agency securities should be provided with this ability. Corporate credit unions or any other financial institution cannot operate long term under a regulation that is written to avoid losses in the worst economic conditions experienced in this country in eighty years.

Recommendation

Apply this strenuous credit spread analysis/modeling to the riskiest sectors of investments to avoid presuming that every bond on a corporate's balance sheet will fail regardless of the credit quality of the underlying assets.

(f) Cash Flow Mismatch Sensitivity Analysis with 50% Slowdown in Prepayment Speeds
This provision is redundant and unnecessary. The Cash Flow Mismatch Sensitivity Analysis referenced above addresses credit spread risk and is good regulatory reform when applied to riskier assets such as non-agency residential mortgage backed securities that warrant such rigorous modeling. The 2-year weighted average life on aggregate assets of a corporate also protects the NCUSIF from potential losses from credit spread risk by limiting durations on any investment held by a corporate. Additionally, the proposed rule includes investment sector limits and prohibits corporates from holding CDOs and NIMS – all providing for protection of the NCUSIF.

Recommendation
Remove the Cash Flow Mismatch Sensitivity Analysis with 50% Slowdown in Prepayment Speeds from the regulation.

704.9 Liquidity Management
(b) Borrowing Limits
Changing the language from *10 times capital or 50% of shares whichever is greater* to *10 times capital or 50% of shares whichever is lower* reduces the amount of liquidity that can be drawn into the credit union system. Of course credit unions can access liquidity from other sources and providing as many liquidity sources as possible for credit unions was one of the principals driving the creation of the corporate network.

Also, the borrowing limits provision within the corporate rule should take into consideration the ability of a corporate to accumulate capital over time and increase borrowing level authorities. For example a corporate with assets of $1 billion and capital totaling $50 million, provides for a borrowing limit of $500 million under the proposed borrowing limits – a reasonable amount. However, using the same example but changing the capital level to $75 million now restricts a better capitalized corporate from accessing more liquidity. The current regulation permits the borrowing limit for a corporate to increase as capital increases, which mitigates the risk associated with increased borrowing levels.

Recommendation
Maintain borrowing limitations as written in the current corporate rule. The current rule states, *"A corporate credit union may borrow up to 10 times capital or 50% of shares (excluding shares created by the use of member reverse repurchase agreements) and capital, whichever is greater.*

704.11 Corporate Credit Union Service Organizations (CUSOs)
(e) Permissible Activities
The proposed revisions to this section are very prescriptive and ambiguous. Permissible activities for corporate owned CUSOs are listed including *"Other categories of services*

as approved in writing by NCUA and published on NCUA's website". This language provides for micro-management of a corporate. Corporates and credit unions must plan, execute, cooperate, be efficient and effective at bringing value to the respective memberships. The ambiguous language used in the proposed rule and sited above will bring the unintended consequence of stymieing planning and cooperation as uncertainty about NCUA's CUSO approval criteria will exist. The current regulatory CUSO rule is a good one.

Recommendation
Maintain NCUA Rules and Regulations Part 704.11 as currently written. The current section 704.11(a)(3) pertaining to CUSO permissible services reads, "*Restricts its services to those related to the normal course of business of credit unions".*

704.14 Representation

(a) Board Representation

It is unnecessary and overly restrictive to include limiting board member terms as a part of regulatory reform. NCUA has the powers now, and under the proposed corporate rule in the Prompt Corrective Action section, to take action as deemed necessary with a troubled corporate. These actions could include replacing boards and management in addition to other administrative actions.

Secondly, limiting eligible credit union professionals desiring to serve takes authority away from member owners of a corporate credit union. Most of the smartest economists and lawmakers in the world did not see the global economic meltdown coming, and limiting corporate credit union volunteers to six-year terms is not going to protect us from the next economic "100 year flood."

Recommendation
The provision dictating a term limit of six years for a corporate credit union director should be removed from the final corporate rule. The right to determine who will serve on a corporate board and for how long should remain in the control of member owners as long as the corporate is in safe and sound condition as defined in the proposed corporate rule.

Conclusion
We at FirstCorp appreciate the opportunity that the National Credit Union Administration Board of Directors is providing in listing our concerns and recommendations related to the proposed amendments to Rules and Regulations Part 704 for Corporate Credit Unions. We support good regulation - good regulation that maintains safety and soundness throughout the corporate network while providing for corporates to add value to credit unions and simultaneously accumulate reserves. Our recommendations listed in this document are made with these goals in mind.

Please contact me at 602.322.2466, or ppritts@firstcorpcu.org, with any questions or comments you may have.

Respectfully,

Pete Pritts
President/CEO

cc. FirstCorp Members
Mr. Scott Earl, ACUL